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**Observation 2:** CERBTF Actuarial Valuations

**Division responsible:** Audit Services

#### Observation:

Employers participating in the CERBTF engage third-party actuaries to perform other postemployment benefits (OPEB) valuations in accordance with the CalPERS *OPEB* Assumption Model. CalPERS actuaries review each valuation for compliance with the CalPERS OPEB Assumption Model; however, current procedures do not include an independent review of the underlying participant data used by the third-party actuaries. Errors in member data may distort valuation results and lead to improper determinations of actuarial accrued liabilities and annual required contributions.

We recommend that the Office of Audit Services perform risk-based, periodic tests of participant data used by the third-party actuaries. The tests should be designed to determine that participant data used in the actuarial valuations is consistent with the participating employers' official records.

### **Current Status:**

IN PROGRESS. Office of Audit Services completed the evaluation and selected a public agency for risk-based periodic testing. As part of a public agency review, the Office of Audit Services completed the test of participant data used in OPEB valuations provided by the employers who participate in the CERBT. The risk-based participant data review is part of a public agency report to be issued as of September 30, 2011.

Observation 4: Real Estate Appraisals

Division responsible: Investment Office

## **Observation:**

Properties held in separate account real estate partnerships are valued based on third-party appraisals directed by CalPERS. Appraised values are adjusted by the general partner to reflect changes in fair value between the appraisal date and the end of CalPERS' financial reporting period. CalPERS' real estate Performance Monitoring Unit (PMU) is responsible for ensuring appraised property values are properly recorded by the partnerships in accordance with the CalPERS' Investment Policy for Real Estate Accounting. During our testing of real estate partnership investments, we noted the following:

- The PMU faces significant challenges in performing the task of verifying that appraised values are being properly reflected in the partnerships' financial statements in a timely manner as there were approximately 1,600 individual properties appraised in fiscal year 2008-09 and only one staff was assigned to perform this function.
- Certain general partners report to CalPERS at the aggregate or fund level rather than the individual property level. In some instances, it was difficult to verify that the appraised values were reflected by the partnerships as property-level financial

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information is not provided by all general partners.

 Appraisals are completed throughout the fiscal year; however there is no process in place to evaluate the changes in fair value from the appraisal date to CalPERS' fiscal year-end.

CalPERS should enhance the current processes by employing the following recommendations:

- 1. Assign the appropriate number of personnel to verify that appraised property values are recorded by the partnerships.
- 2. Require separate account general partners to provide financial information at the underlying property level to facilitate the appraisal verification process.
- 3. For separate account real estate partnerships that were not appraised as of CalPERS' fiscal year-end, review the partnerships' June 30 financial information to ensure significant changes in fair value are properly reflected in the partnerships' June 30 financial statements.

### **Current Status:**

#### IN PROGRESS.

- 1. Although one staff continued to perform the function of verifying that appraised values are properly reflected in the partnerships' financial statements, the number of properties verified at the time of the audit has significantly increased compared to fiscal year 2008-09. CalPERS personnel discussed, with the respective partners, the reasons for variances between appraised values and the partnerships' financial statements, however, we noted CalPERS currently does not have a formal documented policy for following up with the partners in addressing and resolving variances. We recommend that the Investment Office enhance this process by establishing a threshold for investigating variances between the appraisals and partnerships' financial statements. Any variances meeting the threshold should be investigated, resolved and documented in the reconciliation.
- In fiscal year 2009-10, AREIS was not fully implemented and this
  recommendation is anticipated to be implemented in fiscal year 2010-11. As
  AREIS is fully implemented in the future, CalPERS should enhance the
  following processes:
  - Ensure real estate partners provide financial information at the underlying property level for all partnerships in which CalPERS holds a majority effective ownership interest.
  - b. Establish a process to specify the responsible party who will be inputting CalPERS' effective ownership percentage within AREIS.
  - c. Because Investment Office personnel utilize CalPERS' effective ownership percentage from AREIS in verifying that the appraised values are properly reflected in the partnerships' financial statements; CalPERS' effective ownership percentage should be validated by appropriate personnel who possess sufficient knowledge of the partnership agreement and structure. Furthermore, CalPERS' effective

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ownership percentage should be periodically reviewed and updated by appropriate personnel.

3. For properties that were not appraised as of CalPERS' June 30<sup>th</sup> fiscal year-end, the Investment Office should continue to evaluate whether significant changes in fair value between the most recent appraisal and the partners' June 30<sup>th</sup> financial statements are reasonable given known facts and conditions such as the real estate industry and market conditions. CalPERS should also develop a formal documented process including a tolerance threshold for evaluating changes in fair value. This process should be performed for real estate partnerships in which CalPERS holds a majority effective ownership interest.

Target completion date is June 30, 2012.

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Observation 13: Password Requirement Non-Compliance Division responsible: Information Technology Services Branch

### Observation:

We found that password requirements used to access the mainframe applications, RIBS and CRS, currently do not fully adhere to CalPERS' Information Security Identity Authentication Practice in certain key areas. We recommend CalPERS' mainframe administrator update the Resource Access Control Facility (RACF) security settings to ensure that the settings comply with the Information Security Identity Authentication Practice. The Information Security Office should conduct periodic monitoring to ensure compliance.

#### **Current Status:**

IN PROGRESS. The prior year's recommendation remains in process of being addressed. All updates to the current legacy applications, including RIBS and CRS have ceased. As a result, this recommendation will not be fully addressed until the PSR implementation which has been postponed to September 2011.

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Observation 15.4: Shared User Accounts

**Division responsible:** Information Technology Services Branch

## Observation:

Shared accounts are being used by the database administrators when accessing the Oracle database or the VSAM file environment. The use of these shared accounts creates a situation wherein actions taken within the database system cannot be tracked back to a

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specific individual. Inadvertent or malicious activity may not be able to be positively associated with a specific individual essentially eliminating an effective audit trail.

CalPERS Information Technology Services Branch should evaluate the use of shared accounts and discontinue their use where it has been determined there is a risk to the database. Database administrator accounts with schema owner access should be controlled with access granted sparingly and only after proper approval has been granted.

#### **Current Status:**

IN PROGRESS. This prior year recommendation continues to be in the process of being implemented. The User Access Team has reviewed the shared accounts with access to the VSAM files and the Oracle Schema Owner accounts and has received the necessary approvals as required by CalPERS policy. The Guardium SQL appliance that would monitor database access and activity, however, will not be implemented until PSR is active in September 2011.

Observation 15.5: Schema Owner Access

Division responsible: Information Security Office

### Observation:

Database administrator with accounts to the Oracle database or the VSAM environments may potentially have the capability to alter member information affecting benefits payments. Tests have not been conducted to determine if the database systems have sufficient logging triggers or oversight such as file balancing or reconciliations to verify if unauthorized changes can be detected.

The CalPERS Information Security Office should conduct testing to determine if persons with schema owner access to the Oracle database or to the VSAM files can make changes to the database that would affect member benefits without detection.

### **Current Status:**

IN PROGRESS. This prior year recommendation continues to be in the process of being implemented. The Guardium SQL appliance has undergone testing and is planning for full implementation with PSR in September 2011. Until full implementation of the appliance, this recommendation will not be fully addressed.